Supreme Court, U.S.
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88-1399

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PEABODY COAL COMPANY,
A DELAWARE CORPORATION,
Petitioner,

v.

STATE OF ARIZONA, ET AL.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS, STATE OF ARIZONA, DIVISION ONE

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QUESTIONS PRESENTED

1. Whether Arizona's transaction privilege tax, imposed on the privilege of doing business within the state, can lawfully be collected on revenues from coal-mining activity conducted wholly within the borders of the Navajo and Hopi Indian Reservations.

2. In order to determine the validity of taxation of on-reservation activities, are preemption and tribal sovereignty separate, but related, doctrines, or are they simply different approaches to a single overriding inquiry?

LIST OF PARTIES and RULE 28.1 LIST

The parties to the proceedings below were the petitioner Peabody Coal Company and the respondents, the State of Arizona and the Arizona Department of Revenue. All parties below are also before this Court.

Peabody Coal Company is a wholly-owned subsidiary of Peabody Holding Company, Inc., a New York corporation. Peabody Holding Company is owned as follows: Newmont Third Capital Corporation (49.97%), Bechtel Investments, Inc. (15.01%), the Boeing Company (15.01%), Eastern Associated Securities Corp. (15.01%), and the Equitable Life Assurance Society of the U.S. (5%). Peabody Coal Company's subsidiaries and affiliates (other than wholly-owned subsidiaries) are Kayenta Mobile Home Park (a joint venture with Black Mesa Pipeline), Squaw Creek Coal Company (a joint venture with Alcoa), Tecumseh Coal Corporation (Indianapolis P.L. 50%), and Yankeetown Dock Corporation (AMAX C.C. 60%).

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PEABODY COAL COMPANY, A DELAWARE CORPORATION,
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v.

STATE OF ARIZONA AND ARIZONA DEPARTMENT OF REVENUE,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS, STATE OF ARIZONA, DIVISION ONE

The petitioner Peabody Coal Company respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Court of Appeals, State of Arizona, Division One, entered in the above-entitled proceeding on May 10, 1988.

OPINIONS BELOW

The opinion of the Court of Appeals of the State of Arizona is reported at 761 P.2d 1094, and is reprinted in the appendix hereto, p. 1a. The decision of the superior court for the State of Arizona is unreported. It is reprinted in the appendix hereto, p. 17a.

JURISDICTION

Petitioner brought this suit in the superior court for the State of Arizona seeking a refund of transaction privilege taxes paid under protest to the State of Arizona beginning on January 1, 1980. Both petitioner and respondents moved for summary judgment and, on April 11, 1986, the superior court for the State of Arizona granted summary judgment for respondents State of Arizona and Arizona Department of Revenue. The superior court's ruling was finalized in a judgment entered on May 8, 1986, which was the subject of the appeal to the Court of Appeals, State of Arizona, Division One.

On May 10, 1988, the Court of Appeals, State of Arizona, Division One, issued its opinion affirming the judgment in favor of respondents. Petitioner filed a petition for review with the Supreme Court of the State of Arizona, which was denied on October 18, 1988. (Appendix, p. 24a)

The jurisdiction of this Court to review the decision of the Court of Appeals for the State of Arizona is invoked under 28 U.S.C. § 1257(3).

STATUTE INVOLVED

"Arizona Revised Statutes § 42-1306. Levy of tax; purposes; distribution.

"A. There is levied and there shall be collected by the department, for the purpose of raising public money to be used in liquidating the outstanding obligations of the state and county governments, to aid in defraying the necessary and ordinary expenses of the state and the municipalities and counties in this state, to reduce or eliminate the annual tax levy on property for state, municipal and county purposes and to reduce the levy on property for public school education, privilege taxes measured by the amount or volume of business transacted by persons on account of their business activities, and in the amounts to

be determined by the application of rates against values, gross proceeds of sales or gross income, as the case may be, as prescribed by this article.

"B. If any funds remain after the payments are made for state purposes, as provided for by subsection A, the remainder of the funds shall be paid into the state school fund for educational purposes.

"C. The tax levied by and collected pursuant to this article is designated the 'transaction privilege tax'."

STATEMENT OF THE CASE

This action was brought by Peabody Coal against the State of Arizona and Arizona Department of Revenue seeking a refund of transaction privilege taxes paid on Peabody's revenues from its coal-mining operations on the Navajo and Hopi Indian Reservations. The basis for the suit is Peabody's assertion that assessment of the transaction privilege tax on these activities violates principles of federal preemption of state law, infringes upon tribal sovereignty, and violates the commerce clause to the United States Constitution. The matter was decided in the trial court on cross-motions for summary judgment. Inasmuch as there are no factual disputes which affect the outcome of this case, the following statement of facts is quoted from the State of Arizona Court of Appeals' opinion reproduced in the appendix to this petition.

"Peabody is a Delaware corporation with its Arizona headquarters located in Flagstaff, Arizona. Flagstaff is outside the boundaries of any Indian reservation. In 1966, the Navajo and Hopi Tribes and Peabody's predecessor-in-interest entered into two leases pursuant to the Indian Mineral Leasing Act of 1938, 25 U.S.C. §§ 396a–396g. Peabody, under these leases, mines coal from Navajo tribal land at the Kayenta Mine and from Navajo-Hopi joint-use tribal land at the Black Mesa Mine. Peabody sells 100% of the Kayenta Mine coal to a consortium of five electrical utility

participants – Arizona Public Service Company, Department of Water and Power of the City of Los Angeles, Nevada Power Company, Salt River Project Agricultural Improvement and Power District, and Tucson Gas and Electric Company. The company sells approximately 99% of the Black Mesa Mine coal to a consortium of four participants – Southern California Edison Company, Department of Water and Power of the City of Los Angeles, Nevada Power Company, and Salt River Project Agricultural Improvement and Power District. The remaining 1% of the Black Mesa Mine coal is distributed free at the mine site to the Indians for home-heating purposes.

"Arizona has imposed the taxes in question upon Peabody for the privilege of doing business in the state, with the taxes measured by the company's gross receipts or gross income received from these mining operations. Under the agreements with the power consortiums, Peabody is reimbursed in full for the amount of these taxes paid. From July 1, 1970 until December 31, 1979, Peabody paid, without protest, the taxes at issue. From January 1, 1980 through December 31, 1985, Peabody paid these taxes under protest pursuant to A.R.S. § 42-1339(B) (repealed 1986; now § 42-124), and has sought to claim a refund. At the time judgment was entered, the amount in controversy was approximately $42 million.

"In 1983, Peabody brought this suit against the state and the Arizona Department of Revenue seeking refund of the taxes paid under protest. Peabody argued that the application of the taxes to its coal-mining activities conducted on tribal lands violated principles of federal preemption of state law, infringed upon tribal sovereignty, and violated the commerce clause. U. S. Const. art. 1, § 8, cl. 3. Neither the Navajo nor the Hopi Tribes are parties to this litigation.

"Based on cross-motions for summary judgment in April, 1986, the trial court granted the state's motion. The court found that the policies of the Indian Mineral Leasing

Act of 1938, 25 U.S.C. §§ 396a–396g, and the Indian Reorganization Act of 1934, 25 U.S.C. §§ 461–479, as well as the rationale of *Industrial Uranium Co. v. State Tax Comm'n*, 95 Ariz. 130, 387 P.2d 1013 (1963), all supported imposition of the taxes. The court also found that the taxes imposed no burden on the tribes, and caused no infringement upon tribal sovereignty. In fact, the court noted that the taxes directly benefited both tribes, for the reimbursements for taxes Peabody received from the power consortiums contributed to the company's gross revenue, the figure upon which Peabody's royalty payments to both tribes was based. Finally, the trial court noted that the taxes also benefited Peabody, its employees, and the tribes through the mandated expenditure of state funds for health, education and welfare. Thus, the trial court found no preemption, infringement upon tribal sovereignty, or interference with interstate commerce."

On appeal to the Arizona Court of Appeals, the decision of the trial court was affirmed. Insofar as it addressed the issues raised by Peabody in this petition, the Arizona court first addressed Peabody's argument that the state lacks the power to impose a transaction privilege tax for activities conducted on an Indian reservation. The court initially rejected the state's reliance on *Industrial Uranium Co. v. State Tax Comm'n*, 95 Ariz. 130, 387 P.2d 1013 (1963), which held that Arizona transaction privilege taxes could validly be imposed upon a mining company operating within the confines of the Navajo Indian Reservation. The court found that subsequent decisions of this Court have seriously undermined the rationale underlying the holding in *Industrial Uranium*. The Arizona Court of Appeals, however, went on to reject Peabody's argument because "the initial propriety of the tax does not depend upon whether Arizona can lawfully permit or prohibit Peabody from operating within the confines of the Indian reservations but rather depends upon whether Peabody by its operation on the reservations is the beneficiary of any state revenues, including the taxes sought to be imposed here." (Appendix, p. 7a)

Because the court found that Peabody received both direct and indirect benefits from the payment of the taxes in question, the court found a sufficient nexus between Arizona and the "privilege" of doing business in Arizona by Peabody. (Appendix, p. 8a)

The Court of Appeals also determined that neither federal preemption nor principles of tribal sovereignty precluded the assessment of Arizona's transaction privilege tax in this case. In reaching that conclusion, the court first rejected the state's assertion that Peabody lacks standing to argue that the taxes interfere with tribal sovereignty rights. The court also rejected the state's suggestion that it adopt a rule which validates a tax so long as no substantial burden falls upon an Indian or an Indian organization. (Appendix, p. 9a)

The court, instead, formulated its own preemption/sovereignty test based on an examination of a number of this Court's decisions in this area. The Court of Appeals noted that this Court "has not articulated a specific preemption/sovereignty test" but found that the cases all adopted a two-prong inquiry involving "(1) whether a sufficient state interest supported imposition of the tax, despite heavy federal regulation of the taxed activity, and (2) how did the tax directly or indirectly impact upon Indians, that is, where did the economic burden of the tax fall as compared to where the legal burden of the tax was initially imposed." (Appendix, p. 11a)

Because the court determined that both of the elements identified by it had been satisfied, it upheld the tax.

REASONS FOR GRANTING THE WRIT

I. The State of Arizona is without the power to grant Peabody the "privilege" of conducting business on an Indian reservation and it is, therefore, precluded from imposing a transaction privilege tax upon Peabody's coal-mining operations.

By creating and applying a "benefits" test to determine whether the state has the power to impose a transaction privilege tax on Peabody's Indian reservation mining operations, the Court of Appeals adopted a test which fails to make any distinction at all between activities on an Indian reservation and those in the rest of the State of Arizona. Because, though, only the federal government can bestow the privilege of doing business on an Indian reservation, the power to levy a transaction privilege tax on activities within a reservation's borders should be removed from the state.

In *Ramah Navajo School Bd. v. Bureau of Revenue of New Mexico,* 458 U.S. 832 (1982), this Court struck down a New Mexico gross-receipts tax imposed on a non-Indian contractor which built a school for Indian children on a reservation. The New Mexico gross-receipts tax, like the Arizona transaction privilege tax, is intended to compensate the state for granting the privilege of engaging in business. Cf. A.R.S. § 42-1306 and N.M. Stat. Ann. §§ 7-9-3(f) and 7-9-4(a) (1980), quoted in 458 U.S. at 844. In a slightly different factual context[1] this Court noted that the State of New Mexico "has not explained the source of its power to levy such a tax in this state where the 'privilege of doing business' on an Indian reservation is exclusively bestowed by the Federal Government." *Id.*

The Arizona Court of Appeals, though, located Arizona's source of power in the fact that Peabody receives some "benefits" from the state. It therefore found a sufficient nexus between Arizona and the "privilege" of doing business in Arizona by Peabody. (Appendix, p. 8a) Because of the *nature* of a transaction privilege tax, however, the receipt

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[1] In *Ramah*, the New Mexico tax was assessed against a non-Indian contractor hired by a Navajo tribal school board to build a school for Indian children. The tax was passed on to the tribe in *Ramah*, while here there is no direct burden on the Navajo or Hopi Tribes as a result of the collection of the Arizona transaction privilege tax.

or non-receipt of benefits from the state is immaterial when the activity being taxed is conducted on an Indian reservation. In *Ramah*, for example, the state argued that it provided significant services to the Ramah Navajo Indians which justified imposition of the New Mexico tax. This Court rejected that argument because the benefits were unrelated to the construction of schools on Indian land. 458 U.S. at 845, fn. 10. In the case of Peabody, the Court of Appeals has validated the state's attempt to grant Peabody the "privilege" of doing business on the Indian reservation by finding that because substantial sums of money are spent on, for example, education of the tribes, "state revenue benefits flowing to Indians of necessity accrue to the company." (Appendix, p. 7a)

The Arizona Court of Appeals found it necessary to redefine the word "privilege" by writing that it "relates not to the *right* to conduct the business, but to the *benefits* the state bestows on the taxpayer." (Appendix, p. 6a; emphasis the court's) In other circumstances, though, the Arizona courts have clearly stated that the tax is one upon the privilege or *right* to engage in an occupation or business in this state. *Watkins Cigarette Service, Inc. v. Arizona State Tax Comm'n,* 111 Ariz. 169, 171, 526 P.2d 708, 710 (1974); *Tower Plaza Investments Limited v. Dewitt,* 109 Ariz. 248, 250, 508 P.2d 324, 326 (1973). The redefinition of the nature of the tax in order to support its collection on activities conducted on an Indian reservation is a practice which needs this Court's intervention because it presents a question invited, but unanswered by this Court's previous holdings. The "privilege" of doing business on an Indian reservation cannot be granted both by the federal government and by the state. If the nature of a transaction privilege tax is, as it has always previously been held to be, a tax on the granting of the right to do business, then the state lacks the authority to collect this tax from Peabody.

The federal government granted the Indian tribes the power to execute leases such as the one pursuant to which

Peabody conducts its activities in 25 U.S.C. § 396a. That statute provides, in part:

> On and after May 11, 1938, unallotted lands within any Indian reservation or lands owned by any tribe, group, or band of Indians under Federal jurisdiction . . . may, with the approval of the Secretary of the Interior, be leased for mining purposes by authority of the tribal council. . . .

The right to do business by mining coal on the Navajo and Hopi Indian Reservations is granted to Peabody by virtue of its lease with the Indians. The lease exists pursuant to the authority of the federal government. The State of Arizona's desire to increase its general revenue cannot create a means whereby it can tax Peabody for the right to do business within the boundaries of the State of Arizona. "Benefits" or no, a nexus between the state and the granting of the right to do business cannot be found.

This case presents a clean, undisputed record which clearly presents a question of substantial significance both to Peabody and to all other lessees operating businesses on Indian reservations. Certiorari should be granted.

II. The state's collection of a transaction privilege tax has been preempted by federal and tribal law.

Even if the State of Arizona has the authority, in the abstract, to levy transaction privilege taxes on some activities conducted on an Indian reservation, the existence of extensive federal and tribal regulation of Peabody's coal-mining activity in this case preempts the state's right to collect the tax. The preemption question presented by this case, however, is not limited to seeking relief for Peabody from the Arizona tax. Presented here is the broader issue of whether extensive federal and tribal regulation over even the most minute aspects of an activity can, alone, preclude a state from levying a tax.

The Arizona Court of Appeals, in reviewing this Court's cases on the subject of taxation involving non-Indians on Indian reservations, found no articulated specific preemption/sovereignty test. The court wrote, though, that all of this Court's cases involved a two-prong inquiry into whether there is a sufficient state interest to support imposition of the tax (despite heavy federal regulation of the taxed activity) and how the tax impacts upon the Indians. The first prong of this test is, essentially, a preemption question, while the second prong relates to tribal sovereignty. In effect, then, the Arizona court combined preemption and tribal sovereignty tests into a single issue.

In *Ramah*, this Court recognized that there are "two 'independent but related' barriers to the exercise of state authority over commercial activity on an Indian reservation: state authority may be preempted by federal law or it may interfere with the tribe's ability to exercise its sovereign functions." 450 U.S. at 837. The Court previously explained in *White Mountain Apache Tribe v. Bracker,* 448 U.S. 136 (1980):

> The two barriers are independent because either, standing alone, can be a sufficient basis for holding state law inapplicable to activity undertaken on the reservation or by tribal members. They are related, however, in two important ways. The right of tribal self-government is ultimately dependent on and subject to the broad power of Congress. Even so, traditional notions of Indian self-government are so deeply ingrained in our jurisprudence that they have provided an important 'backdrop,' . . . against which vague or ambiguous federal enactments must always be measured. 448 U.S. at 143.

Rather than broadening the scope of federal preemption in the case of Peabody's coal-mining activities, the Arizona Court of Appeals applied a test which, in effect, combined preemption with tribal sovereignty in that it requires an analysis to be made of where the economic burden of the tax falls in conjunction with an analysis of the degree of regulation.

Application of a test such as that created by the Arizona Court of Appeals virtually guarantees that a case will not be decided purely on the basis of federal preemption. So long as the benefits/burden analysis (the tribal sovereignty prong) results in a justification for the tax, then the degree of federal regulation becomes immaterial. Here, for example, there is federal and tribal regulation which permeates Peabody's operations. Because, however, the ultimate burden of the tax does not fall directly on the Navajo or Hopi Indians, it has been upheld.

In *Warren Trading Post Co. v. Arizona Tax Comm'n*, 380 U.S. 685 (1965), this Court found that the Indian trader regulations and the statutes authorizing them indicated that Congress took the business of Indian trading on reservations so fully in hand that no room remained for state laws imposing additional burdens upon traders. The tax there was one levied by the State of Arizona on the gross proceeds of sales or gross income of Warren Trading Post, a company that conducted a retail business on the Navajo Reservation under a license granted by the United States Commissioner of Indian Affairs. There, pursuant to the Indian trader regulations, the Commissioner could specify the kind and quantity of goods and prices at which such goods could be sold, who could qualify as a trader, penalties for acting as a trader without a license, conditions under which government employees could trade with Indians, articles that could not be sold to Indians, and could prescribe conduct forbidden on a trader's premises. The Commissioner could also require that government officials be allowed to inspect the trader's business records, that bonds be executed by proposed licensees, and that the governing body of an

Indian reservation could assess such fees as it deemed appropriate from a trader. In the *Warren Trading Post* case, the regulations, while extensive, were significantly less invasive than those which directly impact upon Peabody's operations. In *Warren Trading Post*, however, preemption was found to have occurred, preventing the State of Arizona from levying its tax.

If preemption has any independent viability, the degree to which the federal government and Navajo Tribe control Peabody's activities should warrant the application of that doctrine without reference to tribal-sovereignty issues, i.e., whether there is a burden on the tribe.

The involvement of the United States in coal-mining operations is indeed vast. Pursuant to 25 U.S.C. § 635, the Secretary of the Interior has adopted extensive regulations which govern Peabody Coal Company's operations and leases executed by virtue of the Indian Mineral Leasing Act of 1938, 25 U.S.C. §§ 396a, et seq. The rules promulgated pursuant to 25 U.S.C. § 635 include requirements that all leases must be in a form approved by the Secretary of the Interior and subject to his written approval. 25 C.F.R. § 162.5. No lease can be approved or granted at less than the fair annual rental. 25 C.F.R. § 162.5(b). Satisfactory surety bonds may be required to assure performance of contractual obligations. 25 C.F.R. § 162.5(c). Additionally, insurance in an amount adequate to protect any improvements must be provided. 25 C.F.R. § 162.5(b)(e). Pursuant to 25 C.F.R. § 211.2, tribes may lease their land for mining purposes after advertising for bids (§ 211.3), with negotiated leases accompanied by a proper bond and other supporting papers to be filed with the Superintendent of the Bureau of Indian Affairs. However, the Secretary of the Interior may reject negotiated leases (25 C.F.R. § 211.2) and direct that they be advertised for bids subject to the Secretary's approval.

Pursuant to 25 C.F.R. § 211.18, Peabody must allow any tribal agent or authorized representative of the Department of Interior to enter upon the leased premises for purposes of an inspection and must keep a full and correct account of all operations, making reports as required by the Interior Department regulations. In addition, the books and records showing the manner of operations and persons interested must be open at all times for examination. In the event a lessee fails to comply with any provisions of a lease or the regulations, penalties can be assessed pursuant to 25 C.F.R. § 211.22.

The Secretary of the Interior has also adopted regulations dealing extensively with surface exploration, mining, and reclamation of lands on the reservation. The stated purpose of such surface exploration and reclamation requirements is to encourage development of the mineral resources underlying Indian land where mining is authorized and to assure adequate measures are taken to avoid, minimize, or correct damage to the environment and/or to the public health and safety. 25 C.F.R. § 216.1. Other sections of 25 C.F.R. discuss the technical examination of prospective surface exploration and mining operations, the basis for a denial of a permit or lease, approval of an exploration plan, and include rules relating to such matters as acid drainage, acid-forming materials, alluvial valley floors, land contours, aquifers, compaction, diversion of canals, flood irrigation, ground water, hydrological balance, enclosed basins, intermittent streams, overburden, productivity, recharge capacity of the soil, road runoffs, sediment ponds, sub-irrigation, surface coal-mining operations, reclamation operations, surface water, toxic-forming materials, waste and water tables. See, e.g., 25 C.F.R. § 216.4, § 216.5, § 216.101.

The foregoing represents only a sampling of the list of federal rules and regulations impacting Peabody's coal-mining operations on the Navajo and Hopi Reservations. Peabody's coal-mining activities are impacted by 25 C.F.R. because it conducts its mining operations on Indian land.

The entire subject matter of Part 25 of the Code of Federal Regulations deals with Indians. Peabody's activities are also governed by the rules set forth in 30 C.F.R., Mineral Resources.

In addition to the myriad of federal regulations, Peabody must operate within the regulatory framework enacted by the Navajo Tribe. Statutes such as 18 N.T.C. §§ 101 and 102 establish a Navajo negotiating team empowered to renegotiate mineral leases or other energy agreements on behalf of the tribe. 18 N.T.C. § 201 establishes the Minerals Department of the Navajo Tribal Council. It is responsible for the encouragement of the development of Navajo minerals, including coal. 18 N.T.C. § 202(b). The responsibilities of the Minerals Department include the inspection of mining properties to protect the health and safety of individual Navajos, as well as to emphasize the removal of all materials that can be marketed at a profit under safe conditions.

There is a specific Navajo Coal Mining Commission established in 18 N.T.C. § 301, et seq., to assist the Office of Surface Mining, Department of the Interior, to regulate coal-mining operations on Navajo lands. The Navajo Coal Mining Commission is also authorized and directed to participate with the Office of Surface Mining in the regulation of coal-mining activities, including enforcement of the federal regulations promulgated under the Surface Mining Control and Reclamation Act of 1977. 18 N.T.C. § 1304(b).

It is apparent that the federal government and the tribes have taken over the regulation and enforcement of all coal-mining activities on the reservations. That intent has been expressed in the federal regulations and by the Navajo Tribe in its code. There is no room left for the state to legislate. Any effort by the state to interfere has been preempted. As in the *Warren Trading Post* case, the state tax cannot stand.

Another case in which this Court invalidated a tax similar to the one attempted here is *Central Machinery Co. v. Arizona State Tax Comm'n*, 448 U.S. 160 (1980). The issue in *Central Machinery* was whether Arizona could tax the sale of farm machinery to an Indian tribe when the sale took place on a reservation and was made by a corporation that did not reside on the reservation and was not licensed to trade with the tribe. As here, the tax in question was a transaction privilege tax. In *Central Machinery*, this Court noted that the State of Arizona's transaction privilege tax is a tax amounting to a percentage of the gross receipts of the taxable entity and is assessed against the seller, not the purchaser. The Court's conclusion was that the assessment and levying of the transaction privilege tax was preempted because federal regulation of Indian trading was so extensive that it prevented application of a state tax to the transaction. The Court reached this conclusion despite the fact that Central Machinery was not a licensed trader and that it did not have a permanent place of business on the reservation. The pervasive federal regulation prevented the imposition of an additional tax by the State of Arizona.

On the same day that it decided *Central Machinery*, this Court issued its opinion in *White Mountain Apache Tribe v. Bracker*. In *Bracker*, this Court held that federal regulation of harvesting of Indian timber was so pervasive as to preclude the additional burden imposed by Arizona's Motor Carrier License Tax and its Use Fuel Tax. The Court found that the state's generalized interest in raising revenue was insufficient to permit it to intrude into the federal regulatory scheme with respect to harvesting and sale of timber.

In all of the cases previously decided by this Court, there was at least some negative economic impact occasioned upon the tribe by the collection of the tax from the non-Indian entity. In Peabody's situation, there is no immediate or direct adverse economic impact visited upon the tribe as a result of Arizona's transaction privilege tax because the tax is passed directly through to the consortium

of buyers of Peabody's coal and because the amount of those payments is included in Peabody's gross receipts upon which its payments to the tribes are based. The collection of the tax by the state, of course, has the indirect effect of preventing the Navajo Tribe from collecting a similar tax at the risk of pricing the coal mined by Peabody out of the market. More importantly, though, the use of a test which includes measuring the economic burden of the tax means that preemption and tribal sovereignty are not two "independent but related barriers to the assertion of state regulatory authority" as stated in *Bracker*, but that the impact on tribal sovereignty is the pivotal, indeed controlling, inquiry.

This case squarely raises the question of whether federal preemption has independent viability separate and apart from tribal-sovereignty issues when the activity in question is conducted on an Indian reservation. If federal preemption principles do provide a separate and independent barrier to the assertion of state regulatory authority, the Court should grant certiorari and review this case in order to clarify application of these doctrines in this and similar cases.

That the view taken by the Arizona Court of Appeals is not its alone is demonstrated by the comment made by the New Mexico Court of Appeals in *Cotton Petroleum v. State of New Mexico*, 745 P.2d 1170 (N.M. App. 1987), No. 87-1327, probable jurisdiction noted April 18, 1988, in which the court wrote that under "traditional preemption analysis, if the taxes do not impact the Tribe, we need look no further." 745 P.2d at 1174.

Lower courts need guidance from this Court as to the appropriate use of the doctrines of preemption and tribal sovereignty, their interplay, and whether the preemption doctrine, standing alone, is ever sufficient to erect a barrier to state regulation or taxation of activities conducted on an Indian reservation.

CONCLUSION

For the reasons set forth herein, this petition for certiorari should be granted.

RESPECTFULLY SUBMITTED,

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FILED May 10, 1988

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

PEABODY COAL COMPANY, a Delaware corporation Plaintiff-Appellant, v. STATE OF ARIZONA and ARIZONA DEPARTMENT OF REVENUE Defendants-Appellees.	)	1 CA-CIV 9317 DEPARTMENT A O P I N I O N

J A C O B S O N, Judge

This appeal concerns whether Arizona can lawfully impose transaction privilege taxes upon Peabody Coal Company (Peabody), a non-Indian coal company, based upon Peabody's sale to non-Indians of the coal it mines entirely from the Navajo and Hopi reservations in Arizona.

I. BACKGROUND

Peabody is a Delaware corporation with its Arizona headquarters located in Flagstaff, Arizona. Flagstaff is outside the boundaries of any Indian reservation. In 1966, the Navajo and Hopi Tribes and Peabody's predecessor-in-interest entered into two leases pursuant to the Indian Mineral Leasing Act of 1938, 25 U.S.C. §§ 396a–396g. Peabody, under these leases, mines coal from Navajo tribal land at the Kayenta Mine and from Navajo-Hopi joint-use tribal land at the Black Mesa Mine. Peabody sells 100% of the Kayenta Mine coal to a consortium of five electrical utility participants – Arizona Public Service Company, Department of Water and Power of the City of Los Angeles, Nevada

Power Company, Salt River Project Agricultural Improvement and Power District, and Tucson Gas and Electric Company. The company sells approximately 99% of the Black Mesa Mine coal to a consortium of four participants – Southern California Edison Company, Department of Water and Power of the City of Los Angeles, Nevada Power Company, and Salt River Project Agricultural Improvement and Power District. The remaining 1% of the Black Mesa Mine coal is distributed free at the mine site to Indians for home-heating purposes.

Arizona has imposed the taxes in question upon Peabody for the privilege of doing business in the state, with the taxes measured by the company's gross receipts or gross income received from these mining operations. Under the agreements with the power consortiums, Peabody is reimbursed in full for the amount of these taxes paid. From July 1, 1970 until December 31, 1979, Peabody paid, without protest, the taxes at issue.[1] From January 1, 1980 through December 31, 1985, Peabody paid these taxes under protest pursuant to A.R.S. § 42-1339(B) (repealed 1987; now § 42-124), and has sought to claim a refund. At the time judgment was entered, the amount in controversy was approximately $42 million.

In 1983, Peabody brought this suit against the state and the Arizona Department of Revenue seeking refund of the taxes paid under protest. Peabody argued that the application of the taxes to its coal-mining activities conducted on tribal lands violated principles of federal preemption of state law, infringed upon tribal sovereignty, and violated the commerce clause. U.S. Const. art. 1, § 8, cl. 3. Neither the Navajo nor the Hopi Tribes are parties to this litigation.

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[1] The taxes at issue are the transaction privilege tax pursuant to A.R.S. §§ 42-1301 to -1347, the education excise tax pursuant to §§ 42-1361 to -1362 (repealed effective July 1, 1985), and the special excise tax for education under §§ 42-1371 to -1372 (repealed effective July 1, 1985).

Based upon cross-motions for summary judgment, in April, 1987, the trial court granted the state's motion. The court found that the policies of the Indian Mineral Leasing Act of 1938, 25 U.S.S. §§ 396a–396g, and the Indian Reorganization Act of 1934, 25 U.S.C. §§ 461–479, as well as the rationale of *Industrial Uranium Co. v. State Tax Comm'n*, 95 Ariz. 130, 387 P.2d 1013 (1963), all supported imposition of the taxes. The court also found that the taxes imposed no burden on the tribes, and caused no infringement upon tribal sovereignty. In fact, the court noted that the taxes directly benefited both tribes, for the reimbursements for taxes Peabody received from the power consortiums contributed to the company's gross revenue, the figure upon which Peabody's royalty payments to both tribes was based. Finally, the trial court noted that the taxes also benefited Peabody, its employees, and the tribes through the mandated expenditure of state funds for health, education and welfare. Thus, the trial court found no preemption, infringement upon tribal sovereignty, or interference with interstate commerce.

Peabody filed a motion for new trial and to reopen under Rule 59(a)(4) and (8), Arizona Rules of Civil Procedure, based primarily on allegedly material new evidence. The new information dealt with a proposed amendment to the transaction privilege tax statutes (which did not pass) which would have provided for the state to share revenue from the taxes with the Hopi and Navajo Tribes, and with documents which purportedly suggested that Navajo Indians were generally opposed to any state taxation within their reservation boundaries. The trial court denied the motion, and this appeal followed.

On appeal, Peabody raises these issues:

1. whether Arizona can impose a privilege tax on an Indian reservation;

2. whether Arizona's authority to exact these taxes has been preempted or whether such taxes interfere with tribal sovereignty;

3. whether the interstate commerce clause has been violated by the levy of these taxes; and

4. whether the trial court erred when it denied Peabody's motion for new trial and to reopen.

II. APPLICATION OF TAXES

The three taxes in issue are taxes based upon the privilege of doing business in Arizona, measured by gross income or gross receipts. A.R.S. §§ 42-1306 (formerly § 42-1309), -1361, and -1371, *State Tax Comm'n v. Howard P. Foley Co.,* 13 Ariz. App. 85, 474 P.2d 444 (1970).

Given the basis of the taxes (the privilege of doing business) Peabody initially questions the state's power to impose them, contending that only the federal or tribal governments may grant the privilege to operate on a reservation. In response to this argument the state relies exclusively upon *Industrial Uranium Co. v. State Tax Comm'n,* 95 Ariz. 130, 387 P.2d 1013 (1963). In our opinion, this reliance is not justified – not because the case does not support the state's position, but because the validity of *Industrial Uranium* has been seriously impaired by subsequent decisions of the United States Supreme Court. In *Industrial Uranium,* the Arizona Supreme Court held that the Arizona transaction privilege taxes (the same taxes which are at issue here) could be validly imposed upon a mining company operating within the confines of the Navajo Indian Reservation pursuant to a lease with the tribe and approved by the Secretary of the Interior. In disposing of most of the same arguments raised by Peabody here, the court relied to a great extent upon the applicability of 25 U.S.C. § 398 to the leases in question. This statute specifically provided that the production of minerals from unallotted lands on Indian reservations could be taxed by the

state in which they were located in all respects the same as production from non-Indian reservation lands. With this clear federal legislative enactment, the court did not need to dwell long on the issue of the state's authority to tax mineral production from an Indian reservation.

However, the federal law interpreting the applicability of 25 U.S.C. § 398 has changed since the *Industrial Uranium* decision. In 1984, the Ninth Circuit held in *Blackfeet Tribe of Indians v. Montana,* 729 F.2d 1192 (9th Cir. 1984), that 25 U.S.C. § 398 is not applicable to leases entered into by Indian Tribes after comprehensive amendments to the Indian Reorganization Act in the area of mineral leasing were added by the Act of May 11, 1938 (codified as 25 U.S.C. §§ 396a–396g (1976)). The court stated:

> We hold that the 1924 Act's consent to taxation [25 U.S.C. § 398] is inapplicable to the 1938 Act and to leases executed pursuant to its authority.

729 F.2d at 1203. Accordingly, the court struck down Montana's attempt to tax oil and gas producers on the Blackfeet Reservation, who in turn deducted the taxes from royalties payable to the Tribe.[2]

On appeal to the United States Supreme Court in *Montana v. Blackfeet Tribe of Indians,* 471 U.S. 759, 105 S.Ct. 2399, 85 L.Ed.2d 753 (1985), the Ninth Circuit's opinion was affirmed. The Supreme Court noted that generally the states may tax Indians only when Congress has manifested clearly its consent to taxation and that statutes are construed liberally in favor of Indians, with ambiguous provisions interpreted to their benefit. The court then held:

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[2] Contrary to the Montana tax which decreased the Blackfeet Tribe's royalties, the Arizona tax actually increases the Navajo and Hopi Tribes' royalties, as is pointed out later.

> When the 1924 and 1938 Acts are considered in light of these principles, it is clear that the 1924 Act [25 U.S.C. § 398] does not authorize Montana to enforce its tax statutes with respect to leases issued under the 1938 Act.

471 U.S. at 766, 105 S.Ct. at 2404, 85 L.Ed.2d at 759-60.

Since the leases involved in *Industrial Uranium* and here were entered into under the 1938 Act, it is apparent that the continuing validity of the holding in *Industrial Uranium* is in serious question. For this reason we pass directly to the merits of Peabody's contentions.

Generally, the fact that a non-Indian business activity occurs on an Indian reservation does not necessarily remove the activity from this state's jurisdiction. *See, e.g., Surplus Trading Co. v. Cook,* 281 U.S. 647, 50 S.Ct. 455, 74 L.Ed. 1091 (1930). Moreover, the incident of the tax is on the "privilege" of doing business in the state, as compared to a tax directly on sales or property. *See, Arizona State Tax Comm'n v. Garrett Corp.,* 79 Ariz. 389, 291 P.2d 208 (1955). In the limited context of Peabody's "privilege" argument, this business privilege should not fall without the state's jurisdiction, unless other considerations prohibit its application. *Arizona Dep't of Revenue v. Hane Constr. Co.,* 115 Ariz. 243, 564 P.2d 932 (App. 1977). Contrary to Peabody's assertion, this "privilege" relates not to the *right* to conduct the business, but to the *benefits* the state bestows on the taxpayer. *See Flagstaff Vend. Co. v. City of Flagstaff,* 118 Ariz. 556, 578 P.2d 985 (1978) (holding that city excise tax could properly be imposed on sales occurring on a state university campus because the on-campus activity received city police and fire protection).

When viewed in this context, the initial propriety of the tax does not depend upon whether Arizona can lawfully

permit or prohibit[3] Peabody from operating within the confines of the Indian reservations but rather depends upon whether Peabody by its operation on the reservations is the beneficiary of any state revenues, including the taxes sought to be imposed here.

We therefore consider the benefits that do flow to Peabody. In doing so we note that the state is not required to show a dollar-for-dollar return of tax money in the form of benefits. *See Thomas v. Gay,* 169 U.S. 264, 18 S.Ct. 340, 42 L.Ed. 740 (1898).

For each of the tax years in issue, over 87% of Peabody's employees at each mine were Indians. Therefore, state revenue benefits flowing to Indians of necessity accrue to the company. The record reveals that from fiscal years 1980–1981 through 1984–1985, the state expended almost $120 million for school districts located wholly on the Navajo and Hopi Reservations, and spent almost $215 million (over five times the amount of taxes Peabody is protesting) to support schools located partially on and partially off these two reservations. These figures include only state general fund expenditures, and not federal funds transmitted through the state to schools. The record also shows that key Peabody employees attended these state-supported schools, and that Peabody's controller's children attend public schools in Flagstaff.

While Peabody contends the state is "volunteering" to support these schools, the state is required to provide such assistance to ensure that all school districts have equal funding to provide required educational programs despite different property tax bases. A.R.S. § 15-971. Three county school superintendents stated that the local school districts which serve the Navajo and Hopi Tribes "absolutely

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[3] No one has seriously contended that the "privilege" involved as the incident of the tax in question rested upon whether Arizona could prohibit a lawful business from operating within its borders.

depend" upon these state equalization payments to provide required education because of inadequate property tax bases upon the reservations.

In addition to state expenditures for schools, the state also spends tax revenues on health and welfare services to benefit Peabody, its employees, and tribal members. The Deputy Director of the Department of Health Services stated that the state spent approximately $720,000 on the Navajo and Hopi Reservations in just two of the years at issue here for programs to combat alcoholism, tuberculosis, and mental illnesses. The administrator of the Office of Planning and Budget Development, Department of Economic Security, indicated that from January 1980 through September 1985, the state spent almost $9 million of state general fund revenues to administer federal programs on the Navajo and Hopi Reservations.

We also note that Peabody's Arizona Division headquarters, where its Arizona business is managed, is on non-Indian land in Flagstaff. Included among its employees and activities at this headquarters are the president of Peabody's Arizona Division, legal counsel, purchasing operations, a director of operations, a director of human resources, a director of engineering, a senior environmental manager, a controller, numerous support staff, and a Peabody Development Company employee working pursuant to a contract for Peabody Coal Company to help with marketing and contract administration. Thus, the company maintains substantial business operations off the reservations that are crucial to its on-reservation work, and there is no contention that these activities are not benefited by state tax revenues. We therefore hold that sufficient benefits flow to Peabody from state tax revenues to provide the nexus between Arizona and the "privilege" of doing business in Arizona by Peabody.

III. PREEMPTION/SOVEREIGNTY

Peabody next argues that even if a sufficient taxable nexus exists between Peabody and the State of Arizona, the power to levy the taxes has been preempted by federal law, or the exercise of the taxation power interferes with rights of tribal sovereignty rights. We disagree. In *Ramah Navajo School Bd. v. Bureau of Revenue,* 458 U.S. 832, 102 S.Ct. 3394, 73 L.Ed. 1174 (1982), the United States Supreme Court stated that to determine whether a state tax may be applied to a business performed on Indian reservation land without violating federal law, federal, tribal, and state interests must be analyzed. "These interests tend to erect two 'independent but related' barriers to the exercise of state authority over commercial activity on an Indian reservation: state authority may be preempted by federal law, or it may interfere with the tribe's ability to exercise its sovereign functions." *Id.* at 837, 102 S.Ct. at 3398, 73 L.Ed.2d at 1179; *White Mountain Apache Tribe v. Bracker,* 448 U.S. 136, 100 S.Ct. 2578, 65 L.Ed.2d 665 (1980). Because the preemption issue cannot be considered without also considering the tribal sovereignty issue Peabody, of necessity, must have standing to raise the issue of interference with tribal sovereignty.

Peabody first argues that the extensive federal and Navajo regulation of its coal-mining activities in and of itself results in a preemption of state law. The state does not really present a solid preemption analysis, focusing on federal, tribal and state interests. Rather, the state urges us to adopt a rule, which it contends is suggested by Indian law cases, that if the burden of a tax legally or economically falls upon Indians or an Indian tribe or enterprise, preemption occurs. If, however, no substantial burden falls upon an Indian or Indian organization, the tax can stand. While this approach may be appealing, and may be the ultimate result in the case law, we are compelled to employ the particularized analysis of interests the United States Supreme Court has applied in such cases.

We start with the proposition that in the area of state taxation of on-reservation activities, regular preemption principles do not apply. *White Mountain,* 448 U.S. at 143, 100 S.Ct. at 2538, 65 L.Ed.2d at 672. Rather, when a

> State asserts authority over the conduct of non-Indians engaging in activity on the reservation . . . [the court has] examined the language of the relevant federal treaties and statutes in terms of both the broad policies that underlie them and the notions of sovereignty that have developed. [The court then conducts] a particularized inquiry into the nature of the state, federal, and tribal interests at stake . . . to determine whether, in the specific context, the exercise of state authority would violate federal law.

Id. at 144-45, 100 S.Ct. at 2584, 65 L.Ed.2d at 673.

The interrelated federal and tribal interests involved in this case are based upon the specific laws regulating a coal-mining business and the general federal policies underlying the Indian Reorganization Act of 1934, 25 U.S.C. §§ 461–479, and the Indian Mineral Leasing Act of 1938, 25 U.S.C. §§ 396a–396g. The general policies underlying these two federal Acts are to achieve uniformity in the law governing mineral leases on Indian land, to revitalize tribal government, to encourage economic development of Indian land, and to maximize the economic return to the tribes. *Montana v. Blackfeet Tribe of Indians,* 471 U.S. 759, 105 S.Ct. 2399, 85 L.Ed. 2d 753 (1985); *Crow Tribe of Indians v. Montana,* 819 F.2d 894 (9th Cir. 1987).

The numerous federal and tribal laws governing coal mining on reservation lands also demonstrate goals of maximizing benefits to the tribes. Peabody has cited extensive statutes and regulations governing virtually every aspect of its coal-mining activities, from the creation of its leases to the reclamation of land. Peabody's mines are regulated

and inspected by the Office of Surface Mining which requires Peabody to submit and gain approval of a complete mining and reclamation plan, with details regarding areas to be mined, productivity, quality, environmental effects on water, air, soil, vegetation and wildlife, and also requires the company to post bonds for reclamation work. Peabody is also subject to general federal laws regarding mine safety, equal employment opportunity, labor relations, and federal contract compliance. Finally, Peabody must pay two Navajo taxes based on its coal-mining activities, business activities and possessory interest taxes, and must work with Navajo and Hopi labor relations offices.

The state does not dispute that federal and Indian regulation of Peabody's activities is comprehensive. However, the state contends that extensive federal regulation alone is not sufficient to lead to preemption of state law, citing *Ramah Navajo School Bd. v. Bureau of Revenue,* 458 U.S. 832, 102 S.Ct. 3394, 73 L.Ed.2d 1174 (1982), *Warren Trading Post Co. v. Arizona Tax Comm'n,* 380 U.S. 685, 85 S.Ct. 1242, 14 L.Ed.2d 165 (1965), *Central Machinery Co. v. Arizona State Tax Comm'n,* 448 U.S. 160, 100 S.Ct. 2592, 65 L.Ed.2d 684 (1980); and *White Mountain Apache Tribe v. Bracker,* 448 U.S. 136, 100 S.Ct. 2578, 65 L.Ed.2d 665 (1980).

Our examination of these and other United States Supreme Court cases demonstrates that while the Court has not articulated a specific preemption/sovereignty test, other than the particularized interests analysis previously mentioned, all cases involved a two-prong inquiry into: (1) whether a sufficient state interest supported imposition of the tax, despite heavy federal regulation of the taxed activity, and (2) how did the tax directly or indirectly impact upon Indians, that is, where did the economic burden of the tax fall as compared to where the legal burden of the tax was initially imposed.

For example, in *Ramah* the Court held that federal law preempted a state tax imposed upon the gross receipts

of a non-Indian contractor for construction of a school for Indian children on a reservation where the tax actually was paid by the Indian school board because it was included as a cost of construction in the contractor's bid. Similarly, in *Warren Trading Post,* the court held that Arizona's transaction privilege tax could not be imposed upon trade with Indians. Federal regulation of Indian traders was extensive, the collection of the tax would have frustrated the congressional purpose that no burden be put on traders for trading with Indians, and at the time the case was decided in 1965, the federal government carried the entire burden for constructing and maintaining schools that benefitted Indians, leaving the state no duties towards the Indians relating to its taxing function. 380 U.S. at 688–91, 85 S.Ct. at 1244–46, 14 L.Ed.2d at 167–69.

Likewise in *Central Machinery,* which held Arizona's transaction privilege tax was preempted, the Court noted that the tax was paid by the Indians. Without any discussion of the state interests involved, the Court summarily rejected imposition of the tax.

White Mountain also demonstrates the application of the Supreme Court's preemption analysis. Motor carrier license and use fuel taxes were held preempted because: (1) the tribal entity involved reimbursed the logging company for all tax liability incurred based on its on-reservation activities; (2) extensive federal regulations controlled logging activities; (3) the taxes would disrupt federal policies of maximizing return to the Indians and other policies created by federal law; and (4) the state did not impose the tax to help maintain on-reservation roads or forests, because the Indians and logging companies were responsible for those activities.

In applying the perceived two-prong analysis we first note, as has been previously discussed, that the state's expenditure of its revenues on the reservations far exceeds the amount of taxes it seeks to collect from Peabody. We, therefore, hold that Arizona has more than a generalized

interest in raising revenues; rather it has an interest associated with governments generally, that is, "seeking tax revenues for the purpose of constructing, or assisting in the effort to provide, adequate educational facilities for [Indian] children." *Ramah,* 458 U.S. at 843 n. 7, 102 S.Ct. at 3041 n. 7, 73 L.Ed.2d at 1183 n. 7.

We next note that rather than these taxes being a burden upon the Indian tribes involved, the taxes enhance their revenues. Because of Peabody's contracts with the power consortiums, the taxes involved here are recovered by Peabody and are included in Peabody's gross realization figure for royalty calculation purposes. In fact, both tribes argued successfully before the Interior Board of Land Appeals of the United States Department of the Interior that these taxes should be included as part of Peabody's gross realization. I.B.L.A. 83-248 (April 29, 1983). Therefore, imposition of these taxes actually furthers the federal and tribal interests by increasing the royalties paid to both tribes.

We therefore hold that the state has demonstrated that its interests in imposing the transaction privilege and now-repealed education taxes were to provide necessary health, welfare, and education benefits to Peabody's employees and to other tribal members. The fact that Peabody also provides services on the reservations, such as building and upgrading roads and providing health services, does not negate the state's expenditures which benefit Peabody, its employees, and non-employee tribal members. The imposition of these taxes upon Peabody for its coal-mining activities on the Navajo and Hopi Reservations furthers the federal and tribal interests and is supported by sufficient state interests. The trial court correctly held that application of the taxes in this case is not preempted by federal law and does not infringe upon rights of tribal sovereignty.

IV. COMMERCE CLAUSE

Peabody next argues that levying these taxes violates the interstate commerce clause, U.S. Const. art. 1, § 8, cl. 3, by creating an undue burden on interstate commerce. As Peabody and the state agree, "a state tax on activities connected to interstate commerce is sustainable if it 'is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.'" *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 156, 102 S.Ct. 894, 911, 71 L.Ed.2d 21, 41 (1982), quoting *Complete Auto Transit, Inc. v. Brady*, 420 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326, 331 (1977).

Peabody's only argument that application of these taxes violates the commerce clause is that the fourth element of this test has not been met because the "state supplies no services on the reservation to Peabody." The state need not show a direct *quid pro quo* relationship between taxes imposed and benefits supplied. *Thomas v. Gay*, 169 U.S. 264, 18 S.Ct. 340, 42 L.Ed.740 (1898). As we have already discussed, the record amply supports the state's assertion that it supplies a variety of necessary educational and health services upon and around the Navajo and Hopi Reservations. These services directly benefit Peabody's employees, the vast majority of whom are members of these tribes, and other tribal members. We hold that the application of these taxes in this case does not violate the commerce clause.

V. NEW TRIAL

Finally, Peabody argues that the trial court abused its discretion by refusing to reopen the case and grant a new trial based on allegedly material newly discovered evidence. Rule 59(a)(4), Arizona Rules of Civil Procedure. Peabody sought a new trial based upon a proposed amendment to the transaction privilege statutes, and comments of the

Navajo Attorney General and the Navajo Tax Commission's Deputy Director which indicated a general opposition to imposition of state taxes to on-reservation activities.

The trial court denied this motion, finding that the evidence was "inadequate and conclusory in nature, legally incorrect in part, and fails to create a genuine issue of material fact or law." The trial court was correct on all counts. The proposed statutory amendment is immaterial as it did not become law. As to the documents purporting to demonstrate the Navajo Tribe's general opposition to the state's exercising its taxing powers within the boundaries of the reservation, these are likewise immaterial. Whether the tribes dislike state taxation in general or did not seek intervention in this litigation is of no legal consequence. As we have demonstrated, the validity of these taxes does not depend upon the feelings of any of the parties, but rather upon a legal analysis of the broader interests involved. We find no abuse of discretion by the trial court refusing to grant a new trial.

CONCLUSION

For the reasons stated, we affirm the trial court's decision in all regards. The state's power to impose its transaction privilege tax and now-repealed special education taxes on Peabody's gross receipts from its on-reservation coal-mining activities has not been preempted, does not interfere with rights of Indian sovereignty, and does not violate the interstate commerce clause. Further, we hold that the trial court did not abuse its discretion by refusing to reopen the case and grant a new trial.

/s/ Eino M. Jacobson

EINO M. JACOBSON, Judge

CONCURRING:

/s/ Robert J. Corcoran

Robert J. Cocoran
Presiding Judge

/s/ J. Thomas Brooks

J. Thomas Brooks, Judge

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CC19-72122	4/11/86	Hon. Thomas W. O'Toole	S. Sanders
Div.	Date	Judge or Commissioner	Deputy

No. C-499407

PEABODY COAL — Jeffrey B. Smith

vs.

STATE OF ARIZONA — Ian A. Macpherson

The following matters have been under advisement.

IT IS ORDERED granting Defendant State of Arizona's Motion for Summary Judgment and denying Plaintiff Peabody Coal Company's Motion for Summary Judgment. Viewing the evidence and reasonable inferences therefrom in a light most favorable to Plaintiff Peabody, the Court finds that there are no genuine issues of material fact and that Defendant State of Arizona is entitled to Summary Judgment as a matter of law.

ISSUE:

Peabody Coal Company seeks recovery of approximately $42,000,000 in transaction privilege taxes it has paid Arizona under protest since 1979. The issue before the Court is whether Arizona can lawfully impose these taxes upon Peabody, a non-Indian business mining coal on the Navajo and Hopi Reservations pursuant to leases with these tribes and selling the coal to non-Indian purchasers, and

without infringing on tribal sovereignty and self government without violating the Federal Constitution, federal laws and the principle of federal preemption.[1]

UNDISPUTED FACTS:

Peabody Coal Company, a Delaware Corporation with Arizona headquarters in Flagstaff, has been mining coal at the Kayenta and Black Mesa Mines on the Navajo and the Hopi reservations since the mid-1960's pursuant to lease agreements with the Navajo and Hopi Tribes executed pursuant to the Indian Mineral Leasing Act of 1938, 25 USC 396a–396g and under related and subsequent agreements with the tribes. Over 99% of the coal is sold to non-Indian power consortiums for use in steam generating plants located at Page and Las Vegas, Nevada. The remaining approximately 1% of coal is distributed free of charge to tribal members desiring the use of coal. Nearly all of the employees at the mines are members of these tribes.

Pursuant to these leases with the tribes, Peabody pays a royalty to the tribes which is calculated and paid based upon the gross sales of coal to the power consortiums ("gross realization"). The state taxes are being paid under protest by Peabody. The cost of those taxes to Peabody is passed on to the purchasers pursuant to their contracts with Peabody. In addition, and as a result of *Kerr-McGee Corp. v. Navajo Tribe*, 471 U.S. , 105 S.Ct. 1900 (1985), Peabody is obligated to pay taxes to the Navajo Tribe retroactive to 1978. Although such state taxes are normally placed into the general fund of Arizona, this does not occur when they are being paid under protest.

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[1] These taxes, which include special excise and education taxes, are imposed pursuant to A.R.S. 42-1309, 1312, 1361 and 1371. The Court finds that Peabody has standing to challenge these assessments and to seek recovery of these monies. 42-1339.

Statutes and case law establish that these taxes are taxes on the seller's privilege to do business in Arizona and are measured by the seller's gross sales receipts, which in this case are Peabody's receipts from the sale of coal to the power consortiums. A.R.S. 42-1390, 1312, 1361, 1371; *Central Machinery Co. v. Arizona State Tax Commission*, 448 U.S. 160, 161–162 (1980); *Industrial Uranium Co. v. State Tax Commission*, 95 AZ 130, 132 (1963).

During the time that the Plaintiff has paid these taxes under protest, Arizona has, pursuant to case law requiring such use, expended approximately $215,000,000 of tax revenues for public services to the Navajo and Hopi tribes and their members. There is no doubt that these expenditures benefit the tribes, Peabody and its many Indian employees, as well as its non-Indian employees residing off the reservation, including those living in Flagstaff where Peabody maintains its Arizona headquarters.

In 1982–1983, Peabody, citing *Industrial Uranium v. State Tax Commission, supra*, argued that it was obligated to pay the tax to Arizona, but the tax should be deducted from gross sales before calculating tribal royalties. The Interior Bureau of Land Appeals (IBLA) disagreed, however, and held that Peabody must calculate and pay tribal coal mining royalties *before* computing and deducting the Arizona tax. IBLA 83-248. During these proceedings, and in the earlier proceedings before the Interior Department in IND-37-MIN, both the federal government and the tribes agreed that Peabody was obligated to pay Arizona taxes. Although it was paying the Arizona taxes under protest at the time, Peabody did not appeal this ruling and currently pays tribal coal royalties pursuant to this formula while still paying the transaction privilege tax to Arizona under protest.

It is undisputed that Federal and Tribal statutes and regulations authorize the existence of and control nearly every aspect of Peabody's coal mining operations on the reservation.

CONCLUSIONS:

A review of the relevant federal, tribal and state interests established by statutes and case law clearly compels the conclusion that the State of Arizona, pursuant to applicable statutes and *Industrial Uranium Co. v. State Tax Commission, supra*, can lawfully impose its transaction privilege tax on Peabody without violating relevant and interrelated principles of federal preemption and infringement, and such does not violate federal law or unreasonably and impermissibly burden and violate the Commerce Clause and the Indian Commerce Clause of the Federal Constitution. Indian Mineral Leasing Act of 1938, 25 USC 396, et seq.; *Blackfeet Tribe* of Indians v. Montana, 471 U.S. ; 105 S.Ct. 2399 (1985); *Kerr-McGee Corp. v. Navajo Tribe*, 471 U.S. ; 105 S.Ct. 1900 (1985) *Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 837–839 (1982); *Central Machinery Co. v. Arizona State Tax Commission*, 448 U.S. 160 (1980); *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 145 (1980); *McClanahan v. Arizona Tax Commission*, 411 U.S. 164 (1973); *Warren Trading Post Co. v. Arizona Tax Commission*, 380 U.S. 685 (1965); *Crow Tribe of Indians v. State of Montana*, 650 F.2d 1104, 1111–1114 (9th Cir. 1981) modified 665 F.2d 1390 (9th Cir. 1982) cert. denied 459, U.S. 916 (1982).

Here the tax upon Peabody does not impose any significant legal or economic burden on the tribes and doesn't infringe, either directly or indirectly, on their sovereignty and exercise of self government. Instead, this tax falls upon Peabody and is being shifted to and ultimately burdens the non-Indian coal consortiums who purchase over 99% of this coal. In similar circumstances, various taxes imposed upon the conduct of business by non-Indians on reservations has been repeatedly upheld against challenges that the state tax was preempted and controlled by Federal law or infringed upon tribal sovereignty. *California State Board of Equalization v. Chemeheuvi Indian Tribe*, 474 U.S. , 106 S.Ct. 289 (1985); *State of Washington v. Confederated Tribes*

of the Colville Indian Reservation, 447 U.S. 134 (1980); *Moe v. The Confederated Salish & Kootenai Tribes of the Flathead Reservation*, 425 U.S. 463 (1976); *Fort Mojave Tribe v. The County of San Bernardino*, 543 F.2d 1253 (9th Cir. 1976) and *Department of Revenue v. Hane Construction Co., Inc.*, 115 AZ 243, 245–246 (App. 1977). See also Interior Department decision 47 I.D. 124, 126, 129 (1940) cited with approval 1965 in *Warren Trading Post v. Arizona Tax Commission, supra*, 690, where the Interior Department recognized in 1940 that non-Indian businesses doing business on the reservation with non-Indians must pay state sales taxes on such activity, though not when doing business with Indians.

The conclusion that the tax is valid is bolstered by the fact that these taxes greatly benefit the tribes, Peabody and its employees, both directly and indirectly, in the form of the mandated expenditure of general funds by Arizona for the health, education and welfare of those residing on and off the reservations. In particular, although Peabody has paid approximately $42,000,000 in taxes under protest since 1979, Arizona has expended approximately $120,000,000 in general funds for schools located solely within the reservation boundaries and a total of $215,000,000 for school districts located on and partially off the reservations.

That the tax does not violate principles of preemption and infringement and the goals of the Mineral Leasing Act of 1938 and Indian Reorganization Act of 1934 or revitalizing and encouraging tribal self government and economic self sufficiency is also supported by the fact that the Federal Government and the Navajo and Hopi tribes, who are conspicuously absent from and have not intervened in this action, have already actively recognized and agreed that the tax is being properly imposed upon Peabody. In particular, *In re Peabody Coal v. Hopi Indian Tribe*, IBLA 83-248 (4/29/83), which proceedings were held after the Supreme Court had decided *Warren, Central Machinery, Bracker* and *Ramah* in favor of the tribes on preemption-infringement

grounds, the Interior Department and the tribes, although agreeing with Peabody on the validity of the Arizona tax and the holding of *Industrial Uranium*, argued vigorously, though opposed by Peabody, that this tax was part of Peabody's cost of doing business that was being passed on to the power consortiums, and that tribal royalties should be calculated based upon the amount of gross revenues realized by Plaintiff before deducting the tax. This position prevailed.[2] In prevailing before the IBLA, the tribes cited similar cases, including *Knife River Coal Mining Co.*, 29 IBLA 26 (1977) upholding similar taxes on the non-Indian seller of Indian minerals. Peabody did not further appeal and is now paying royalties to the tribes based upon gross revenues available before deducting any Arizona tax.

Unlike the state tax on tribal oil and gas royalty income that was finally held improper and violative of principles of preemption and tribal sovereignty in *Montana v. Blackfeet Tribe of Indians, supra*, 2402–2404, here the tribal royalties are not adversely impacted by this tax. There is no evidence that the tax adversely affects tribal sovereignty and their ability to obtain royalties or tax revenue from Peabody. In fact, because this royalty is calculated upon gross realization – sales, tribal royalties are increased as a result of the tax being contractually passed on to the buyers in the form of increased prices. Thus, the tax promotes tribal sovereignty and the congressional intent of furthering tribal independence and economic self sufficiency as expressed in the Indian Mineral Leasing Act of 1938, *supra*, the Indian Reorganization Act of 1934, *supra*,

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[2] Since Peabody did not gain an advantage or obtain judicial relief by asserting the validity of this Arizona tax and *Industrial Uranium* in its royalty dispute before the IBLA, and the IBLA decision did not decide the issue of validity of the Arizona taxes upon Peabody, Arizona is incorrect in urging that Peabody is judicially estopped from taking a different position before this Court regarding the validity of the tax. In fact, Peabody was paying the taxes under protest in 1983 when it appeared before the IBLA. *Hellyer v. Hellyer*, 119 AZ 365, 367 (App. 1978); *Standage Ventures, Inc. v. State*, 114 AZ 480, 483–484 (1977).

and cases cited above,including *Kerr-McGee, Blackfeet, Ramah, Bracker, Central Machinery* and *Crow Tribe of Indians v. State of Montana.*

In conclusion, it is clear that imposition of the transaction privilege tax upon Peabody's gross sales greatly benefits the federal interest in nurturing tribal sovereignty, self government and financial independence, is not preempted by any federal statutory or regulatory scheme, does not infringe in any way upon tribal self-government and does not violate the Commerce Clause or Indian Commerce Clause of the Federal Constitution. Defendant State of Arizona is therefore entitled to Summary Judgment as a matter of law.

SUPREME COURT

STATE OF ARIZONA

October 19, 1988

RE: PEABODY COAL COMPANY vs. STATE OF ARIZONA/ARIZONA DEPARTMENT OF REVENUE
Supreme Court No. CV-88-0294-PR
Court of Appeals No. 1 CA-CIV 9317
Maricopa County No. C-499407

GREETINGS:

The following action was taken by the Supreme Court of the State of Arizona on October 18, 1988, in regard to the above-referenced cause:

ORDERED: Petition for Review = DENIED.

Chief Justice Gordon did not participate in the determination of this matter.

Record returned to the Court of Appeals, Division One, Phoenix, this 19th day of October, 1988.

DAVID R. COLE, Clerk